IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO **DIVISION OF FINANCIAL MANAGEMENT** **JANUARY 2004 VOLUME XXVI NO. 7**

As we begin a new year, the magic of the Christmas giving season is behind us and the reality of the January bill-receiving season is upon us. This tradition is as old as shopping on credit. Another tradition is the fear American consumers are finally tapped out, and spending will head south faster than Santa trying to visit the last dozen houses on his list at a quarter to six on Christmas morning. This concern is not trivial. Because of its sheer size, consumer spending determines the severity of economic slow downs. For example, the 2001 recession was one of the mildest on record because consumers continued spending. The recession ended over two years ago, so it is an opportune time to recap the financial condition of American consumers.

It is no secret Americans like to spend, even when money is short. In fact, consumers have been spending money faster than they have been earning it in every year but one from 1993 to 1999. Consumers accomplished this feat by saving less and borrowing more. One consequence of this spending spree is the personal savings rate fell from 8.7% in 1992 to a low of 2.3% in 2001. The long-term average (1959-98) is 8.4%. Consumers were also willing to take on more debt. After the 1990-91 recession, non-mortgage consumer debt more than doubled from $0.8 trillion in 1992 to $1.9 trillion in 2000.

Consumers' behavior during this period reflected their confidence in the economy. There were several good reasons for this confidence. After a slow start, job growth became robust in the 1990s. It was so strong that it sent many economists back to their drawing boards to rethink their estimates of full employment. Many believed the full-employment threshold to be an unemployment rate in the neighborhood of 5.5%. The national unemployment rate dropped below this in June 1996 and remained there until November 2001. Americans also rallied around the surging stock market that soared 18% annually from 1992 to 1999. These strong gains helped household net worth rise to more than six times disposable personal income in 1999, which was well above the long-run average of net worth to disposable income of 4.8. Americans became wealthier in the 1990s, even as savings dropped and debt soared. While it was not enough to make them light cigars with dollar bills, it was sufficient to make them spend beyond their means.

Unfortunately, consumers were rudely evicted from Easy Street when the stock market began to dive. Consumer confidence dropped below 100 for the first time since the start of 1999. Consumer confidence was further rocked by the September 11, 2001 terrorist attacks. And as if that was not enough, confidence was further pummeled by corporate finance scandals and the war with Iraq. With so many blows to consumer confidence, it was feared consumers would run for cover. They did not. Consumer spending did slow, but it did not retreat.

Low interest rates breathed a much-needed second wind into consumer spending during and after the 2001 recession. Interest rates on a non-bank car loan dropped from 6.3% in 1998 to 4.3% in 2002. Over the same period the mortgage rate for existing homes slipped from 7.1% to 6.5%. Not surprisingly, both vehicle and home sales surged. The lower mortgage interest rates also released a flood of home refinancing. This had a positive impact on spending. The lower rates dropped monthly mortgage payments, which freed funds for further consumer spending. Some homeowners took out home equity loans that provided another means for spending.

Consumers' finances seem to have stabilized despite creeping non-mortgage consumer debt. One reason for this is debt is growing more in line with income. As a result, the non-mortgage debt has remained about 24% of disposable income since 2001. Another plus is the low interest rates have made it easier to make payments on this debt. After peaking at 13.3% in 2002, the ratio of debt service to disposable income eased slightly to 13.2% in 2003.

It should not be interpreted that consumers' finances are safely in order. While finances have stabilized, they have done so at record levels. For example, the ratio of debt to income is about 24%, which is much higher than the historical norm of 18.5%. And while the ratio of debt service to income has eased in 2003, at 13.3% it is much higher than the long-term average of 11.5%. It should also be noted that since debt service is tied to interest rates, rising interest rates could cause this ratio to rise higher than the current level. This is a concern because current interest rates are so low they are more likely to move up than down over the near term.

The vulnerability of debt servicing to interest rates can be seen in the current economic forecast. The ratio of debt to income is anticipated to continue falling through 2007 thanks to restrained spending and decent income growth. However, the ratio of debt service to income remains relatively high, the result of rising interest rates. Should these rates rise higher than anticipated, Americans will find it even harder to make their monthly payments.

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General Fund Update

As of December 31, 2003

Revenue Source	FY04 Executive Estimate[3] ($ Millions)	DFM Predicted to Date ($ Millions)	Actual Accrued to Date ($ Millions)
Individual Income tax	895.8	426.7	427.1
Corporate Income tax	100.1	44.1	36.8
Sales Tax	884.1	452.6	450.3
Product Taxes[1]	45.3	23.2	22.7
Miscellaneous	150.9	89.1	91.4
TOTAL GENERAL FUND[2]	**2,076.2**	**1,035.7**	**1,028.2**

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
2 May not total due to rounding
3 Revised Estimate as of January 2004

General Fund revenue was $7.5 million lower than expected in December, the first time revenues have been below the target this fiscal year. The weakness was concentrated primarily in the corporate income tax, with sales tax and product taxes also down but offset by strength in the individual income tax and miscellaneous revenues.

Individual income tax revenue was $0.4 million higher than expected in December. On the collection side, withholding collections were $3.8 million lower than predicted and filing payments were $3.9 million higher than predicted for the month of November. Refunds and miscellaneous diversions were $0.3 million lower than expected.

Corporate income tax revenue took a dive in December, coming in $7.3 million lower than expected. Filing payments were $2.0 million below expectations, while quarterly estimated payments were $3.4 million lower than predicted. Refund payments compounded the problem, with $1.9 million more paid out than was expected for the month.

Sales tax revenue turned in its lowest performance of this fiscal year in December, coming in $2.3 million lower than expected. Interestingly, three prior months (July, August, and November) had gains that exceeded expectations by more than $2.3 million. December's results reflect retail activity in November. Some of the weakness can be attributed to a relatively late Thanksgiving, which resulted in a shortened holiday sales season falling into November. This was compounded by reports of a weak start to the Christmas selling season. Recent reports suggest that sales strengthened considerably in late December. This gives rise to optimism that December's sales (January's revenues) will bounce back.

Product taxes were $0.5 million lower than expected for December due to weakness associated with the cigarette tax. Miscellaneous revenues were $2.3 million above target for the month of December. Once again, unclaimed property receipts were higher ($2.6 million) than expected for the month.